S T A T E O F M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **MICHIGAN CONSOLIDATED GAS COMPANY** for approval of a gas cost recovery plan, 5-year forecast, and monthly gas cost recovery factors for the 12-month period ending March 31, 2012.	)	Case No. U-16482

NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on February 29, 2012.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before March 14, 2012, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before March 26, 2012. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Mark E. Cummins

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Mark E. Cummins
Administrative Law Judge

February 29, 2012
Lansing, Michigan

S T A T E O F M I C H I G A N

STATE OFFICE OF ADMINISTRATIVE HEARINGS AND RULES

FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **MICHIGAN CONSOLIDATED GAS COMPANY** for approval of a gas cost recovery plan, 5-year forecast, and monthly gas cost recovery factors for the 12-month period ending March 31, 2012.	)))))))	Case No. U-16482

PROPOSAL FOR DECISION

I.

HISTORY OF PROCEEDINGS

On December 22, 2010, Michigan Consolidated Gas Company (Mich Con) filed an application, with supporting testimony and exhibits, seeking approval of its gas cost recovery (GCR) plan and factors for the 12-month period ending March 31, 2012. That filing was submitted pursuant to section 6h of 1982 PA 304 (Act 304), as amended, MCL 460.6h. As set forth in its application, Mich Con sought authority to assess a maximum GCR factor for the 12-month period consisting of the sum of a base factor of $5.89 per thousand cubic feet (Mcf) and a contingency factor that, based on changes in the New York Mercantile Exchange (NYMEX) gas commodity prices, could serve to alter the utility's maximum GCR factor.

Pursuant to due notice, a prehearing conference was held on February 1, 2011, before Administrative Law Judge Mark E. Cummins (ALJ). Mich Con, Attorney General

Bill Schuette (Attorney General), the Residential Ratepayer Consortium (RRC), the Michigan Community Action Agency Association (MCAAA), and the Commission Staff (Staff) participated in the proceedings. In the course of the prehearing conference, the ALJ granted intervenor status to the Attorney General, the RRC, and MCAAA, and established a schedule for the remainder of the case.

Consistent with that schedule, evidentiary hearings were conducted on June 7, 2011. In the course of those hearings, testimony was received from nine witnesses, five from Mich Con and one each from the Attorney General, the RRC, MCAAA, and the Staff. The resultant record consists of 359 pages of transcript and 59 exhibits, each of which was received into evidence. Both initial and reply briefs were filed by Mich Con, the Staff, the Attorney General, the RRC, and MCAAA on June 30, and July 25, 2011, respectively. Subsequently, and in conformance with prior Commission directives, Mich Con filed monthly reports regarding the data and determinations relating to the monthly contingent factors computed and applied with respect to its GCR sales. The most recent of these reports was submitted to the Commission on February 15, 2012.

II.

STATUTORY REQUIREMENTS

Subsection 6h(3) of Act 304 requires a utility with a GCR clause to annually file a complete GCR plan describing the expected sources and volumes of its gas supply and the changes in the cost of gas anticipated over a future 12-month period. Based on this information, the utility is to request specific GCR factors for each of the 12 months in its

GCR plan. The GCR plan must also describe all major contracts and gas supply arrangements for the 12-month period.

Subsection 6h(4) of Act 304 also requires the utility to file--contemporaneously with the submission of its GCR plan--a five-year forecast of its gas requirements, anticipated sources of supply, and projections of its gas costs.

Subsection 6h(5) of Act 304 provides that, after a utility files its GCR plan and five-year forecast, the Commission is to conduct a proceeding to evaluate the reasonableness and prudence of the GCR plan and to establish GCR factors for the period covered by the plan. It further provides that this review shall be conducted as a contested case proceeding pursuant to Chapter 4 of the Administrative Procedures Act of 1969, 1969 PA 306, as amended, MCL 24.201 et seq.

Subsection 6h(6) of Act 304 provides that, in its final order in a GCR plan case, the Commission shall evaluate the reasonableness and prudence of the decisions underlying the utility's plan and shall approve, disapprove, or amend the plan accordingly. In evaluating the decisions underlying the utility's plan, this subsection continues, the Commission shall consider the volume, cost, and reliability of the major alternative gas supplies available to the utility; the cost of alternative fuels available to some or all of the utility's customers; the availability of gas in storage; the ability of the utility to reduce or eliminate any sales to out-of-state customers; whether the utility has taken all appropriate steps to minimize the cost of purchased gas; and other relevant factors. This subsection also provides that the Commission must, in its final order regarding the plan, specifically approve, reject, or amend the 12 monthly GCR factors requested by the utility. Although those factors are to be described in fixed dollar amounts per unit of gas, they may include specific amounts contingent on future events.

Subsection 6h(7) of Act 304 provides that the Commission, in its final order regarding the GCR plan, shall evaluate the decisions underlying the utility's five-year forecast. The Commission may also indicate any cost items in the five-year forecast that, on the basis of the present evidence, the Commission would be unlikely to permit the utility to recover from its customers in rates, rate schedules, or GCR factors established in the future.

III.

TESTIMONY AND POSITIONS OF THE PARTIES

Mich Con presented a combination of direct and rebuttal testimony from five witnesses in support of its 2011-2012 GCR plan. The utility asserts that this testimony, along with its related exhibits, demonstrates that the decisions underlying its plan are reasonable and prudent. Thus, Mich Con contends, the Commission should approve its GCR plan, including the proposed use of a monthly NYMEX-based contingent factor mechanism, and authorize the utility to implement initial monthly GCR factor in the amount of $5.89 per Mcf.

The first witness offered by the utility was its Manager of Market Forecasting, George H. Chapel, who described Mich Con's GCR demand forecast for the five-year operational period running from April 2011 through March 2016. According to him, the company's projected Gas Cost Recovery/Gas Customer Choice (GCR/GCC) sales, which are projected to be 155.4 billion cubic feet (Bcf) for the 2011-2012 plan year, will decrease to 152.1 Bcf by the end of that five-year period. Mr. Chapel further described such matters as (1) Mich Con's decision to begin relying on 15-year weather normalization, as opposed to alternative weather normalization techniques used in prior cases, (2) the company's rate schedule market sales forecast techniques, (3) the utility's basis for concluding that its GCC program will grow by approximately 15,000 customers per year over the five-year period addressed in his testimony, (4) Mich Con's reasons for concluding that its 2012 peak day load requirements will likely drop from last year's projected level, and (5) the company's ongoing conservation assumptions drawn from its recently-filed Energy Optimization plan.

The utility's second witness was W. Bernard Kramer, a Regulatory Compliance Consultant for DTE Energy Company's [DTE] Corporate Services Division. By way of his testimony, Mr. Kramer provided an overview of the various Federal regulatory issues that affect Mich Con's activities (and the costs associated with them), particularly with regard to both interstate and Canadian interprovincial pipeline gas transportation. Specifically, Mr. Kramer offered information outlining (1) the utility's activities before the Federal Energy Regulatory Commission [FERC], (2) ANR Pipeline Company's [ANR's] annual fuel re-determination filing, (3) the FERC's investigation into the rates charged by Great Lakes Transmission Company, (4) the forecasted rates for services provided by ANR, and (5) Mich Con's forecast of the firm gas transportation rates likely to be charged by its other interstate suppliers.

The third witness offered by Mich Con, and who provided both direct and rebuttal testimony, was Jennifer C. Schmidt, a Principal Project Manager also employed by DTE Corporate Services. Ms. Schmidt's direct testimony addressed the calculation of Mich

Con's proposed monthly base GCR factor for the 2011-2012 plan year, the utility's proposed contingent factor mechanism and its implementation, and the company's five-year forecast of its cost of gas. In her rebuttal testimony, she explained why a recommendation offered by the Attorney General's witness, which would require Mich Con to undertake an analysis of any impediments to switching from its current last in/first out (LIFO) gas inventory accounting method to a weighted average cost of gas (WACOG) methodology, would be inappropriate.

The utility's fourth witness was Eric W. Clinton, a Principal Analyst in Mich Con's Gas Supply and Planning Department. Through his direct testimony, and relying in part on information previously offered by Mr. Chapel, Mr. Clinton explained the company's gas supply plan for the entire five-year planning period. In so doing, he described how Mich Con's overall gas purchasing strategy uses a mix of fixed price purchases (FPP) and market-based indexed price supply to meet its projected needs, that the utility strives to hedge price uncertainty by using the Volume Cost Averaging (VCA) methodology of purchasing fixed price supply approved by the Commission's September 28, 2010 order in Case No. U-16146 (the September 28 order), and that the cost of all non-FPP gas will correspond to market-based indices, which float until the particular delivery period for such gas begins. Mr. Clinton further (1) noted that the utility's price forecast for the 2011-2012 GCR plan year is based on the average settled prices for the first five trading days of December 2010--which, he asserted, was the most recent information available when this case was filed, (2) described how the appropriate supply requirements are determined for each ensuing month throughout the GCR plan year, (3) explained why Mich Con revised, and continues to revise, its gas transportation portfolio, (4) showed how the utility arrived at its projected total supply requirements of 121 Bcf, at a cost of $718 million--including transportation charges--for the GCR plan year, (5) detailed the projected volumes and costs giving rise to the LIFO-based valuation of stored gas costs used in this proceeding, and (6) explained how, in the company's view, its gas supply strategy for April 2012 and beyond is consistent with that utilized for the plan year at issue in this proceeding.

Mr. Clinton also provided rebuttal testimony responding to various issues raised by witnesses offered by the RRC, the Attorney General, and MCAAA. With regard to the presentation offered by the RRC's witness, Mr. Clinton explained how GCR customers benefit from the utility's proposed levels of hedging, how NYMEX futures prices do accurately measure settled prices, how those futures prices reflect real market prices, how the company did not actually deviate from its proposed 75% level of FPP coverage, and why the Commission has no valid reason for revisiting its earlier decision to allow Mich Con to use the VCA-based FPP program approved in the September 28 order. With regard to statements provided by the Attorney General's witness to the effect that the VCA method should not be relied upon for the GCR plan year in question, Mr. Clinton went on to assert--among other things--that that use of the VCA method is appropriate under both current and expected gas market conditions, and that gas prices have not become stable and predictable, thus necessitating its use. Finally, with regard to claims by MCAAA's witness regarding the need to focus on purchasing gas during the April/May and September/October periods, he pointed out that other factors--such as heating demands, hurricanes, etc.--"can influence gas prices during shoulder months" such as those. 2 Tr 134.

The last witness offered by Mich Con was Barbara J. Goodwin, another Principal Analyst in Mich Con's Gas Supply and Planning Department. By way of her testimony, Ms. Goodwin detailed the utility's operating plan for the 2011-2012 GCR plan period. In doing so, she outlined how the planned purchase goals were developed for both colder-than-normal (CTN) and warmer-than-normal (WTN) weather, how stored gas and flowing supply--as well as the expected prices for each--factored into the process, and how the company's estimated peak day supply levels all led to the development of Mich Con's operational plan. Moreover, through her rebuttal testimony, Ms. Goodwin described why--at least from the utility's perspective--opposition expressed by both the RRC and the Staff to the company's proposed reduction in storage allocation for GCR/GCC customers was unwarranted.

Based on the testimony and exhibits provided by these witnesses, Mich Con contends that its presentation fully satisfies the requirements of Act 304, and that adequate consideration has been given to the potential for CTN and WTN weather in developing both its gas purchase and storage operation proposals. The utility thus claims that the Commission should specifically (1) approve its 2011-2012 GCR plan, including the purchasing structure proposed in its application, (2) authorize the implementation of GCR factors consisting of a $5.89 per Mcf base factor plus any additional amounts derived from the operation of its proposed contingent factor adjustment mechanism, and (3) accept as reasonable the utility's five-year forecast.

Frank J. Hollewa, an independent energy consultant, testified on behalf of the RRC. According to Mr. Hollewa, his analysis of the results produced by Mich Con's FPP program in past years (as well as the likely effect of the utility's transition to the

VCA method for making its FPP in the present plan year) led him to conclude that the Commission should (1) revisit its decision to allow use of the VCA method for Mich Con's FFP program, (2) assuming it allows the utility to continue using that methodology, significantly reduce the allowable level of purchases made pursuant to that program both in the present and future plan years, and (3) hold the company responsible for all costs arising from its use of the VCA-based FPP program that exceed the available monthly index prices posted since October 5, 2010. Moreover, Mr. Hollewa asserted that Mich Con's proposal to reduce the GCR/GCC customers' allocation of storage capacity from 80.0 Bcf to 71.7 Bcf is wholly unwarranted and should be rejected. Based on that testimony, the RRC asserts that maximum levels of gas obtained pursuant to the VCA purchasing method should be reduced (at least for the next two GCR plan years), if the Commission elects to suspend use of the VCA method, an alternative method closely resembling that used by Consumers Energy Company should replace it, the utility should bear the cost consequences from FPP for the 2011-2012 plan year that exceed the purchase levels subsequently approved in this case, and the company's request to reduce the storage allocation for GCR/GCC customers should be rejected.

The Attorney General offered testimony from one witness, consulting economist Ralph E. Miller. In the course of his testimony, Mr. Miller asserted that the primary reason underlying the Commission's approval of Mich Con's VCA purchasing method in the September 28 order--namely the unpredictable character of the natural gas market faced by the utility--no longer exists. Specifically, he stated that "a growing consensus of knowledgeable experts" indicates that "the gas market has now entered a period of lower and much more stable prices." 2 Tr 274. Moreover, Mr. Miller indicated that the utility's VCA purchasing strategy, when coupled with the 75% FPP target, would likely cause the company to incur gas costs for the 2011-2012 GCR plan year that are much higher than necessary. On a separate topic, Mr. Miller indicated that the arguments supporting Mich Con's past use of LIFO accounting when pricing the gas consumed by its GCR/GCC customers--specifically, that Internal Revenue Service (IRS) tax considerations or other federal obstacles would make any change to the accounting structure impractical, and that changing the method of accounting for stored gas would cause a large increase in Mich Con's base rate revenue requirements--are no longer valid. Based on the above-noted testimony, the Attorney General contends that the Commission should reject the utility's VCA-based FPP plan in its entirety, and should also require the company to both conduct a study and file a report regarding the current feasibility of changing from LIFO to WACOG accounting when computing the cost of storage gas.

Like the RRC and the Attorney General, the Staff offered testimony and exhibits from one witness, Nyrhe U. Royal, a Public Utilities Engineer in the Commission's Regulated Energy Division. According to Ms. Royal, Mich Con's proposed 8.3 Bcf reduction in the amount of storage capacity assigned to its GCR/GCC customers was excessive. Although recognizing that Mich Con's annual sendout has declined in the recent past, thus supporting some degree of reduction in the amount of storage reserved for these customers, she asserted that the utility should assign "75.85 Bcf of cyclable storage capacity to GCR/GCC customers," consisting of 68.85 Bcf for both normal and CTN working gas utilization, 2.0 Bcf of convertible base gas, and 5.0 Bcf of

WTN contingency space. 2 Tr. 298. Of the 4.15 Bcf storage reduction that her recommendation would entail, Ms. Royal continued, 2.0 Bcf should be recallable in the event that Mich Con needs that storage for use in serving its GCR/GCC customers in the near future.

The final witness presented in this case was that offered by MCAAA, namely William A. Peloquin, an independent consulting economist. By way of his testimony and exhibits, Mr. Peloquin offered four propositions. Foremost among these issues, and one he has addressed in various forms in the past, was his assertion that Mich Con's purchases from affiliated gas suppliers--like Michigan Gathering and Transportation Company (MGAT)--should all be subject to a ceiling price equivalent to the "city-gate monthly index price." 2 Tr 356. As a second, and closely-related matter, Mr. Peloquin renewed his request for the Commission to take steps to limit the impact of affiliate transactions on public utilities like Mich Con. Third, he recommended that the Commission reject in its entirety (both for the 2011-2012 GCR plan year and for all subsequent periods) the utility's use of a NYMEX-based contingent factor mechanism to boost the company's approved GCR factor in case of an unforeseen jump in natural gas prices. Fourth, Mr. Peloquin advocated requiring Mich Con to "investigate the benefits of purchasing a majority of its storage gas during the valley months of April/May and September/October," and to provide reports on this issue in both the reconciliation portion of this proceeding and its next GCR plan case. In addition to supporting those four proposals, MCAAA agreed with other parties' requests to reduce or suspend VCA-based FPP levels, and further suggested that the Commission simply defer ruling on the utility's request to reduce the amount of storage capacity allocated to its GCR/GCC customers.

IV.

DISCUSSION AND FINDINGS

Several of the major areas of dispute typically arising in the course of a GCR plan case are absent in this proceeding. These include such matters as Mich Con's general market and sales volume forecasts (including the selection of a weather normalization methodology), the level and type of pipeline capacity included in the utility's gas acquisition plan, its design day and minimum storage balances, the company's envisioned protection against CTN weather, its planned operations in the event of WTN weather, and its projected gas supply costs. The ALJ therefore finds that, based on the supporting testimony and exhibits offered by Mich Con, those components of the utility's GCR plan are reasonable and prudent, and should be approved. Similarly, due to the absence of any direct challenge to its general structure (and notwithstanding the various future effect that some related arguments and proposals could have on its specific projections), the ALJ likewise recommends accepting the five-year forecast submitted by the utility without the issuance of any specific Section 6h(7) warnings.

Nevertheless, there are six general areas for which disagreements among the parties do exist, and thus warrant discussion in this case. The first concerns whether the recently-adopted VCA method should be used to satisfy all of Mich Con's FPP gas needs, as well as whether a lower percentage of the utility's overall gas purchases should be subject to its FPP structure. The second involves whether the company's proposal to reduce the storage allocation for its GCR/GCC customers from 80 Bcf to 71.7 Bcf is justified. The third and fourth areas of conflict arise from MCAAA's requests to eliminate the NYMEX-based contingent mechanism in its entirety, as well as requiring Mich Con to perform a study regarding the potential benefits of purchasing a majority of its storage gas during the April/May and September/October periods. The fifth dispute concerns the Attorney General's proposal to essentially reopen the issue concerning the feasibility of changing from LIFO to WACOG accounting when computing the cost of storage gas. The sixth issue to be addressed involves MCAAA's numerous requests regarding the treatment of affiliate transactions, both in the context of the GCR plan addressed in this case and in various future proceedings. Each of these matters is discussed below.

Use of the VCA Method for Meeting FPP Requirements

A key issue in this case concerns precisely how Mich Con should go about making its FFPs in the upcoming years. In the utility's previous GCR plan proceeding, Case No. U-16146, both the company and the intervenors analyzed various strategic alternatives for securing FPP volumes. Based on those parties' competing analyses, the Commission agreed with Mich Con and held that "implementation of the VCA purchasing method is reasonable and prudent." The September 28 order, pp. 21-22. Nevertheless, the same three intervenors contend that the Commission should revisit this precise issue, and either eliminate, modify, or significantly restrict usage of the VCA method on a going-forward basis.

As noted earlier, the Attorney General's witness, Mr. Miller, bases his proposal to eliminate use of the VCA purchasing strategy on the assertion that overall gas market conditions have changed dramatically since last year. Specifically, he contends that due primarily to "rapid technological progress in the extraction of natural gas from the shale formations that contain enormous gas reserves in many parts of the United States," the supply curve for natural gas has flattened to the point that "gas industry is now able to achieve large increases in the supply of gas at wellhead prices in the neighborhood of $5.00 [per Dekatherm (Dth)] or even lower." 2 Tr 277. As a result, he asserts that gas prices "are now much more resistant to the types of upward pressure" that, in the past, "could cause them to rise several dollars per Dth and remain at a higher level for months at a time." Id. Thus, because the Commission's recent adoption of the VCA methodology for use by Mich Con was based largely on the existence of an unpredictable gas market, Mr. Miller feels that an inadequate basis exists for continuing the utility's use of that method in acquiring future FPP volumes.

Based on the assessment provided by his witness, the Attorney General requests that the Commission reject the VCA-based FPP plan in its entirety, lest Mich Con's customers be charged an excessive price for natural gas. Interestingly, however, neither the Attorney General nor his witness specifically suggest a methodology to be used in place of the VCA process.[1] See, Attorney General's initial brief, pp. 7-13.

[1] When specifically asked whether the Commission should approve an alternative FPP plan in the context of this proceeding, Mr. Miller replied as follows:

> No, not in the present proceeding. There is no need for Mich Con to make any further fixed price purchases between the time the Commission issues its final order in the present proceeding . . . and the beginning of Mich Con's next GCR period on April 1, 2012.

2 Tr 275.

As for the RRC, its witness, Mr. Hollewa, offered an analysis of Mich Con's FPP program and the results it has produced over each of the past five GCR periods (albeit, in so doing, he relied on estimates developed for the 2010-2011 GCR plan year). See, 2 Tr 240-241. As a result of this analysis, he concluded that the utility's FPP program produced more than $1.0 billion in excess gas costs over that five-year period when compared with what those total costs would have been if the same volume of gas had been purchased at monthly index prices. Id., pp. 241-242. According to Mr. Hollewa, this constitutes "compelling evidence that fixed price purchasing has been ineffective for [Mich Con's] GCR customers from an economic standpoint." 2 Tr 242. Moreover, his review of NYMEX price projections--which form the basis for VCA purchase prices--led him to conclude, among other things, that FPP volumes should constitute much less than 75% of the utility's total gas purchases, that the timeframe for making those purchases should be shortened, and that a modified version of the previously-used Quartile Indices Method (QIM) for satisfying FPP volume levels would produce better results than the VCA method. 2 Tr 242-255.

Based on Mr. Hollewa's testimony, the RRC offers three recommendations regarding the utility's FPP structure. First, it asserts that Commission should revisit the FPP issue, suspend use of the VCA methodology, and instead adopt the modified QIM structure for making FPP purchases as discussed by Mr. Hollewa and described on pages 6 and 7 of the RRC's initial brief. Second, if the Commission instead elects to retain use of the VCA method, the RRC proposes that it reduce the overall purchase levels made pursuant to the VCA-based FPP program from 75% of Mich Con's total annual needs "to a maximum of 50% for the 2012-2013 GCR year and a maximum of

30% for the 2013-2014 GCR year." RRC's initial brief, p. 10. Third, it recommends that the Commission require Mich Con "to bear the cost consequences of [its FPP program] for 2011-2012 that exceed approved purchase levels." Id.

For its part, MCAAA recommends two changes to the utility's proposed VCA-based FPP plan. With regard to its first proposal, MCAAA asserts that making 75% of Mich Con's total annual gas purchases via use of the VCA approach "crowds out too many opportunities to purchase gas on a market basis when prices are low," and instead relies on "a mindless, formulistic approach" that only serves to absolve the company of "responsibility and the exercise of judgment relative to the timing of purchases." MCAAA's reply brief, pp. 1-2. Thus, it contends that a smaller percentage of Mich Con's total gas purchases should be made through the FPP plan approved as part of the September 28 order. As for MCAAA's second proposal, it suggests that the FPP structure should include a mechanism by which the utility would be required to cease purchasing gas for one or two months when an unusually large and rapid rise in market prices occurs. See, MCAAA's initial brief at p. 69 and its reply brief at p. 1. In light of the fact that Mich Con's 75% FPP gas acquisition goal envisions purchasing 3.125% of its future plan needs during each of the 24 months ending December of the GCR plan year, a two-month purchasing hiatus would not, MCAAA asserts, place either the utility or its GCR customers at significant risk.

In addition to the three intervenors involved in this proceeding, the Staff also weighed in on this issue. Noting that it supported Mich Con's shift to the use of VCA in the utility's previous GCR plan case, and further pointing out that this purchasing methodology "is still in its infancy," the Staff "is not recommending any modifications" to the company's VCA-based FPP plan at this time. Staff's initial brief, p. 3. Nevertheless, the Staff went on to state that it expects Mich Con to continually use its expertise and discretion when both developing and administering the utility's FPP strategy in such a way that would minimize the cost of gas borne by its customers, as required by Act 304. See, Id. In addition, the Staff indicated that it expects the company to continue reviewing this purchasing strategy, share the results of that review with interested parties, and "provide support for the VCA or any alternative [purchasing] strategies based on the most up-to-date data and analysis possible." Id.

In general support of the FPP plan proposed for approval in this case, Mich Con points out--as it did in Case No. U-16146--that VCA is essentially a timing technique for purchasing its FPP volumes each month over a defined period in order to achieve a fixed price coverage ratio by a specified date. See, Mich Con's initial brief, p. 4. Based on testimony provided by Mr. Clinton, the utility asserts that:

> VCA provides upward [natural gas] price protection, downward price participation, a year over year smoothing effect on the GCR factor, and most importantly, it is a simple and effective way to manage risk and dampen natural gas price uncertainty or volatility. In general, VCA operates so that Mich Con will lock-in 75% of [its] supply requirements at fixed prices over a two-year period through 24 monthly [FPP] purchases. The 75% fixed price range coverage ratio is achieved 3 months prior to the GCR period. Because the 2011-2012 GCR period is a transition year, Mich Con is targeting a 75% fixed coverage ratio of winter-only flowing supply by October 31, 2011.
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> In addition, Mich Con will determine the timing of each intra-month purchase based on [factors like] willing counterparties, creditworthiness, market liquidity, market outlooks, fundamentals, weekly national underground storage reports, the current economic environment, and other best available intelligence at the time of purchase. Utilization of these factors will ensure that intra-month purchases are executed in a reasonable and prudent manner.

> Also, the target percent of [the FPP] is set at 75% because, as the Commission acknowledged in approving the VCA in Case No. U-16146, the 75% fixed price coverage ratio provides protection from future price uncertainty due to the fact that the price is known for 75% of the portfolio prior to the GCR period. Basically, this is a form of insurance to protect against future price increases that could cause financial harm to Mich Con's customers. For example, if there is a severe price increase during the GCR period, then customers are insulated from this price increase since only 25% of the portfolio is exposed to such a price increase. Lastly, the 25% of market price floating supply allows Mich Con to reduce purchases in the event that actual GCC migration, [WTN] weather, or conservation resulting from ongoing energy efficiency initiatives occur in a manner different than the best available intelligence suggested at the time Mich Con filed this GCR case.

Mich Con's initial brief, pp. 4-5 [citing 2 Tr 95-97]. For the above-quoted reasons, the utility asserts that the VCA-based FPP aspect of its overall gas purchasing strategy for the 2011-2012 GCR plan year is reasonable and prudent.

In response to intervenors' claims that the VCA-based FPP program approved by the Commission's September 28 order is no longer appropriate under either current or expected natural gas market conditions, Mich Con contends that continuation of the program is fully supported by the record. In this regard, the utility cites rebuttal testimony offered by Mr. Clinton to the effect that the key to any gas-price hedging program like the one the company seeks to continue in the present case is that it be "consistently applied over an extended period of time." Id. at 7 [citing 2 Tr 130]. Here, Mr. Clinton noted that, at the time the rebuttal filings were made in this proceeding, the VCA method had only been is place six months since the Commission approved its use in Case No. U-16146, and that switching to some other FPP methodology "would deny a consistent application of the VCA method over an extended period of time, which is necessary for a FPP [program] to be successful." Id. As for claims by the Attorney

General's witness that natural gas prices have stabilized and become predictable due to advances in extracting gas from shale formations, Mr. Clinton testified that such a "reaction to recent and potentially temporary market phenomenon is the type of speculative bias that warrants a disciplined approach to mitigating gas price volatility" by consistently adhering to a FPP program over an extended period. 2 Tr 131. Turning to the assertion that using the VCA methodology would have produced FPP prices in excess of market prices had the program been in place during 2009 and 2010, Mich Con's witness noted that Mr. Miller's analysis:

> [W]as based on only one type of market price environment, which is a falling price environment exhibited over 2009 and 2010. Differing purchasing strategies will produce different financial results in each unique market price environment.
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> * * *
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> The fact that a short run approach may have resulted in superior results in any one year provides no constructive insight in developing a Fixed Price Purchase Program for future use.

2 Tr 132-133. Finally, turning to the RRC's recommendation that the 75% fixed price coverage ratio should be dramatically reduced or, alternatively, that Mich Con should be required to adopt a modified QIM program for procuring its FPP volumes, Mr. Clinton testified that no analysis was provided in this case in support of either of those two proposals. See, 2 Tr 126-127. Based on the above-cited testimony and arguments, the utility contends that the Commission should renew its support for the VCA-based FPP program adopted in the September 28 order and requested for application during the 2011-2012 GCR plan year.

Having thoroughly reviewed and considered the parties' competing arguments, as well as the evidentiary support provided for each, the ALJ concludes that the Staff's mid-ground position constitutes the most reasonable course of action, at least in the context of this particular proceeding.

As noted by several of the intervenors, natural gas prices have both declined and become less volatile as of late. This situation could, if shown to be a long-term trend as opposed to a brief phase, serve to support several of the suggestions currently offered by the Attorney General, the RRC, and MCAAA with regard to the acquisition of FPP gas supplies. Nevertheless, the record does not conclusively show that long-term natural gas prices have become so stable and predictable as to abruptly abandon the VCA-based FPP strategy first approved by the Commission in Mich Con's previous GCR plan case. As pointed out in Mr. Clinton's rebuttal testimony, the cost analysis presented by the Attorney General's witness was based primarily on data drawn from a single type of market price environment, namely a period in which gas prices were--in essence--steadily declining. See, 2 Tr 132. With regard to the RRC's conclusion that the Commission should immediately reduce Mich Con's 75% fixed price coverage ratio or require the utility to use a modified QIM structure when procuring FPP volumes, little or no actual analysis was sponsored in support of either alternative. See, 2 Tr 126-127. The same is true of MCAAA's proposal to simply require that, on any occasion in which gas prices increase rapidly, the company should be directed to cease buying any FPP gas for the following month or two.

As correctly pointed out by the Staff, the VCA-based FPP structure is still in its infancy. As such, and in light of the record as a whole, the ALJ agrees that either abandoning or significantly altering that purchasing structure in the current case could well constitute an overreaction based on a perceived--but inadequately proven--long-term trend in natural gas market prices. The ALJ therefore finds that Mich Con's request to continue its reliance on the VCA method when acquiring FPP volumes for use during the 2011-2012 GCR plan year should be granted. Nevertheless, in light of the potential benefits to GCR customers of making greater use of market-based purchases (at least as long as the natural gas market is in a period of lower, stable prices), the ALJ further concludes that the utility should monitor this situation closely and be prepared (in the future) to either reduce its FPP coverage ratio or shorten the existing 24-month gas acquisition period. As a result, the ALJ also supports the Staff's request that Mich Con be ordered to undertake an in-depth review of its FPP strategy, share the results of that review with all interested parties, and provide (in all upcoming GCR proceedings) support of VCA or any other purchasing strategy through use of the most up-to-date information it can assemble.

Consistent with the discussion set forth above, the ALJ recommends that the Commission authorize Mich Con to continue using the VCA methodology approved in the September 28 order, when acquiring its FPP gas for the 2011-2012 GCR plan period, while also requiring that the utility (1) closely review that strategy in light of both recent and expected market prices for gas, (2) openly share the results of its analysis regarding what FPP strategy and fixed price coverage ratio make the most sense in the future, and (3) provide substantial support--by way of the most current data available—for whichever purchasing strategy it proposes for use during the 2012-2013 period or beyond.

Reducing the Storage Allocation for GCR/GCC Customers

Mich Con contends that its total gas sendout--as well as its rate schedule sales volume, which consists of sales made to GCR/GCC customers--has dropped noticeably during the past several years, and that those annual volumes are expected to continue decreasing throughout the period covered by its five-year forecast. See, i.e., 2 Tr 30 and 2 Tr 46-47. According to the utility's witness on this matter, Mr. Chapel:

> Mich Con believes that a portion of this load reduction is permanent due to a number of factors. First, there is a time sensitive load reduction. By this I mean that there continues to be ongoing replacement of old equipment with newer and more efficient equipment such as furnaces, water heaters, and appliances. Also, household energy efficiencies are gained by the demolition of older, less well-insulated houses and with the construction of new homes built with better building materials.
>
> Potentially less permanent are load reductions that are reflective of higher natural gas prices. The data suggests that customers will react to higher natural gas market prices by reducing their natural gas consumption in a variety of ways, from adding insulation and new windows to their existing homes, to dialing down their thermostats and delaying furnace use in the fall, and hastening furnace turn-offs in the spring.

2 Tr 47.

As mentioned earlier, Mich Con's filing in this case envisions an 8.3 Bcf reduction in the amount of storage reserved for use by its GCR/GCC customers, which is based largely on the fact that its annual gas sendout has declined in recent years. Specifically, although the utility's operational structure for the prior GCR plan year--as approved in the September 28 order--reflected an allocation of 80 Bcf of cyclable storage capacity to its GCR/GCC customers, the company proposes to assign only 71.7 Bcf for potential use by those customers during the 2011-2012 plan period. See, Mich Con's initial brief, p. 20. According to the utility, this reduction is "consistent with the storage allocation methodology presented last year in Ms. Goodwin's 5-year forecast testimony," which, it asserts, was ultimately approved by the Commission. Id. Along those lines, and in further support of its position, the company asserts that:

> This allocation methodology maintains the same ratio of storage to annual sendout of 43.5% as premised in the [the Commission's March 5, 2009 order in Case No. U-15628 that initially] that allocated 80 Bcf of cyclable storage to GCR/GCC customers. Using the same ratio of storage to send-out yields an allocation reduction from 80 Bcf to 71.7 Bcf in this case due to the load reductions that occurred since Case No. U-15628 was decided. Furthermore, for the remaining years of the five year forecast as sendout continues to deteriorate, this storage allocation methodology adjusts the GCR/GCC storage allocation to maintain this same relationship of storage to annual sendout. As sendout changes, this allocation methodology will achieve prudent and reliable storage levels, and winter flowing supply necessary for supply reliability and long term reliable systems operations.

Id., pp. 20-21 [citations omitted]. For these reasons, Mich Con seeks Commission approval of its proposal to reduce the amount of storage dedicated to its GCR/GCC customers by 8.3 Bcf for the plan year in question.

Both the RRC and the Attorney General recommend rejecting the utility's proposed reduction in the amount of storage space held available for use by these customers. Based on a review of historical sendout and storage usage levels, the RRC's witness, Mr. Hollewa, noted that the normal weather storage figure upon which Mich Con's proposal is based actually corresponds to the company's estimate for the 2014-2015 GCR plan year, instead of the period at issue in this case. See, RRC's initial brief, p. 8 [citing 2 Tr 260]. He further pointed out that the total estimated sendout for the prior GCR plan year (160.3 Bcf) was actually lower than the figure estimated in the present case (164.8 Bcf) for the 2011-2012 plan year. See, Id., p. 9 [citing 2 Tr 260-262]. Thus, based on Mr. Hollewa's assertion that the proposed 8.3 Bcf reduction in cyclable storage capacity assigned to Mich Con's CGCR/GCC customers "is wholly unwarranted" at this time, the RRC recommends that the Commission reject that proposal in its entirety. Id., pp. 8-9 [citing 2 Tr 256]. The Attorney General fully agrees with the RRC's position on this issue. See, Attorney General's reply brief, p. 4.

Although not advocating the explicit rejection of the utility's proposal to reduce GCR/GCC customers' storage capacity in the course of this proceeding, MCAAA does express strong opposition to the concept in general. Specifically, MCAAA asserts that:

> Jurisdictional ratepayers were charged with the cost of rate base and working capital applicable to 80 Bcf of storage capability in Mich Con's last gas rate case, . . . [and the utility now seeks] to reduce the jurisdictional storage capability to the benefit of Mich Con but without any benefit to the ratepayers. (Note: reducing the storage capability assigned to GCR and GCC customers allows Mich Con to increase non-jurisdictional storage rentals/leases).

MCAAA's initial brief, p. 64. As a result, MCAAA recommends that any reduction in the storage capacity provided to the utility's GCR/GCC customers should be deferred to the company's next general rate case. See, Id.

For its part, the Staff notes that (at least according to Mich Con's witnesses) the utility's sendout for the 2011-2012 GCR plan year is projected to be about 19 Bcf lower than it was three years ago. As a result, the Staff concedes that the company will likely have to reduce the amount of storage capacity assigned to its GCR/GCC customers. See, Staff's reply brief, p. 1. Nevertheless, the Staff takes issue with Mich Con's claim that it should be allowed to "proportionally [reduce] its GCR/GCC storage capacity to maintain the same storage-to-annual-sendout ratio that arose from the settlement in Case No. U-15628 . . . throughout its five-year plan." Id. According to the Staff, the Commission orders cited by the utility "did not specifically consider the appropriate storage-capacity-to annual-sendout ratio," and in no way indicated that the company's proposed ratio "is the right one for this case." Id., pp. 1-2. Moreover, the Staff asserts that Mich Con should conduct "a full cost-benefit analysis that evaluates its operational objectives and other cost-benefit factors before [it] can determine the correct GCR/GCC storage capacity." Id., p. 3. As a result, the Staff essentially adopts a mid-ground position regarding the level of storage space that should currently be reserved for use by Mich Con's GCR/GCC customers. Specifically, it contends that until such an analysis is conducted, the 4.15 Bcf storage capacity reduction recommended by its witness, Ms. Royal, constitutes the best alternative for the Commission to adopt at this point in time, albeit with 2.0 Bcf of that reduction specifically designated as recallable storage. See, Id., pp. 3-4.

The ALJ agrees with the Staff and finds that, although the Commission should allow Mich Con to reduce the amount of storage capacity reserved for its GCR/GCC customers, any such reduction should be limited to 4.15 Bcf, as opposed to the full 8.3 Bcf reduction sought by the utility [thus dropping the total volume of storage reserved for these customers from its current level of 80 Bcf to a new level of 75.85 Bcf]. The record clearly reflects that the company's total sendout has declined over the last several years, and further indicates that a substantial portion of that decline is based on increased energy efficiency and other customer-based efforts to reduce their natural gas usage. Nevertheless, the utility's analysis of this issue ignores, to a significant degree, the role that the downturn in Michigan's economy had on its overall sendout levels during the last few years.[2] With economic indicators pointing toward an

[2] Although Mich Con offers the Commission's March 5, 2009 order in Case No. U-15628 as support for its claim that the proposed 8.3 Bcf reduction is needed to maintain the storage capacity-to-annual sendout ratio, the ALJ agrees with the Staff and the intervenors that such a citation is of little value in the present proceeding. Specifically, that case: (1) dealt solely with Mich Con's request for authority to

improved financial situation, at least for the near term, it would appear that the more moderate reduction suggested by the Staff's witness makes sense, at least until Mich Con presents a cost-benefit analysis for use in accurately identifying the most reasonable level of storage capacity to be reserved for GCR/GCC customers in the future. Moreover, in light of what appears to be at least a marginal resurgence in the state's overall economic forecast, the Staff's suggestion that 2.0 Bcf of the 4.15 Bcf storage reduction should be recallable (specifically, released for periods of one year or less), also appears to be in the best interest of both the utility and its customers.

As a result, the ALJ recommends that the Commission reject Mich Con's proposed 8.3 Bcf reduction in the amount of annual storage capacity held for use by its GCR/GCC customers, adopt the Staff's proposal to reduce that level by only 4.15 Bcf pending submission by the utility of a cost-benefit analysis supporting a different level of retained storage capacity, and further require that 2.0 Bcf of that capacity be released solely on a recallable basis.

The Contingent Mechanism and Valley Month Purchases

In addition to its suggestions regarding affiliate transactions, each of which is addressed below, MCAAA has raised two fairly narrow issues regarding Mich Con's gas purchasing and pricing proposals. The first of these concerns MCAAA's request to reject the utility's plan to continue its long-standing application of a NYMEX-based contingency factor. The second involves MCAAA's suggestion that the company be

sell 4 Bcf of native base gas due to better-than-expected results from capital improvements made to its gas storage facilities; (2) was settled by the parties; and (3) failed to reflect an explicit agreement by the parties--let alone the Commission--to establish some immutable storage capacity-to-annual sendout ratio.

required to perform a study assessing the potential benefit of purchasing a majority of its storage gas during the valley months of April/May and September/October.

According to its witness, Mr. Peloquin, MCAAA contends that the contingency mechanism "is no longer needed." 2 Tr 350. This is, he contends, due to both "regulatory changes" (such as Mich Con's ability to obtain general rate relief on an accelerated basis, roll-over GCR under-recoveries, use up to 2 Bcf of convertible base gas in price-spike situations, and lock-in 75% of its FPP through application of its VCA program) and the recent development of "natural gas supplies from fractionated shale" (which, he predicts, will reduce gas price volatility due to its relatively high volume and low cost). 2 Tr 350-352. In addition to the reasons cited by Mr. Peloquin for its discontinuance, MCAAA asserts that the contingency mechanism "adds unnecessary complexity and confusion" to the tariff rates charged by Mich Con, and "reduces [the utility's] incentive or discipline to avoid gas price spikes." MCAAA's initial brief, p. 2.

As for the proposed study regarding when the most economical times to buy storage gas might arise, Mr. Peloquin opined that "the new low cost abundant supply of shale gas will result in a rapid expansion of natural gas fueled electric generation," which could increase the overall demand (and thus the average price) of natural gas in the summer and--albeit, to a lesser extent--winter months. 2 Tr 353. He therefore asserted that, because the off-peak periods for electric generation "are the spring months of April/May and the fall months of September/October," those valley months "will become the low price months for the natural gas industries." 2 Tr 354. Based on this testimony, MCAAA requests that Mich Con be ordered to investigate a valley month purchasing scenario for storage gas, and report on its findings in both the reconciliation phase of the current case and in the context of its next GCR plan proceeding.

Mich Con responds by contending that neither of the above-mentioned requests should be granted. With regard to the contingent factor, the utility contends that its continued use is necessary to avoid the situation in which an unexpected jump in the market price for natural gas produces a significant under-recovery for the plan year in question. Because any such under-recovery would be rolled into the following year's GCR factor calculation, the lack of a contingent factor would result in the shifting of costs from one year to another. See, Mich Con's initial brief, pp. 31-32. Moreover, the company contends that, because the contingent factor mechanism proposed in this proceeding is essentially identical to that approved by the Commission in the utility's last GCR plan case, MCAAA's current opposition to its use is barred by the doctrine of collateral estoppel. See, Mich Con's reply brief, pp. 2-4.

Turning to the request to study and report on the alleged benefit of buying storage gas during the valley months of April/May and September/October, the utility offers three reasons for rejecting that proposal. First, it claims that insufficient data has been offered showing that valley months actually occur and will continue to do so over the long term. See, Mich Con's reply brief, p. 35. Second, the company notes that because use of its proposed VCA method for its FPP will result in Mich Con purchasing 3% of its projected 2-year supply of gas each month regardless of whether the month could be considered a peak or off-peak month, this "eliminates the need to consider purchasing the majority of its storage gas during the 'valley months' as suggested by Mr. Peloquin." Id. Third, the utility asserts that, despite Mr. Peloquin's apparent belief to the contrary, electric generation is not the only factor that could influence gas prices during the purported valley months. Rather, the company notes, heating demand and hurricanes also influence gas prices during those four months. As such, Mich Con finds no valid reason to be put to the task of conducting the study requested by MCAAA.

The only other party to weigh in on either of these proposals was the Staff, which asserted that eliminating the contingent factor mechanism "would be an overreaction and unnecessary." Staff's initial brief, p. 3. While noting that the mechanism has not been triggered recently, the Staff contends that this fact does not, by itself, justify eliminating a structure that has proven useful in the past and will likely do so in the future. See, Id., pp. 3-4. The Staff therefore recommends that the Commission reject MCAAA's request, and instead approve the contingency mechanism described in Mich Con's filing.

The ALJ agrees, in large part,[3] with the arguments offered by Mich Con and the Staff. As stated by the utility's witness on the first of these two issues, Ms. Schmidt:

> Mich Con's proposed contingent factor matrix allows Mich Con to mitigate an under-recovery that would result from an increase in market prices above those used in the GCR plan. Without a contingent mechanism, the incremental costs resulting from such a price increase cannot be recovered during the GCR year using the base GCR factor. Any under-recovery resulting from increases in market prices would be rolled forward into the next year's GCR calculation, shifting costs from one year to another. Mich Con's contingent factor matrix mitigates this cost shifting by allowing the GCR factor to reflect specific amounts contingent on future market information.

2 Tr 72. Moreover, and as correctly noted by the Staff, the mere fact that Mich Con's contingent mechanism has not been triggered recently does not deprive it of all potential

[3] The one area where the ALJ does not agree with Mich Con concerns the utility's claim that collateral estoppel precludes MCAAA from requesting the elimination of the company's contingency factor. As has been repeatedly noted in the past, the Commission is free to choose a new direction from one case to another, so long as that new direction results in just and reasonable utility rates.

usefulness in the future. Thus, until there is a more certain showing that market prices for natural gas will remain both stable and predictable over a long period, the ALJ finds that MCAAA's request to ban implementation of the utility's proposed contingent factor mechanism should be rejected.

As for MCAAA's other request, namely that the Commission require Mich Con to conduct and present (in future GCR proceedings) a study regarding the potential advantages of purchasing storage gas during the asserted valley months of April/May and September/October, the ALJ concludes that inadequate justification has been provided for demanding such action. In support of this conclusion, the ALJ notes that MCAAA's witness himself conceded that "available historic data [regarding the effect of shale gas production] is sparse," and that his proposal was based solely on gas prices arising over a two-year period. See, 2 Tr 354. Moreover, and as correctly pointed out by Mich Con, the VCA method--which the ALJ has recommended using during the GCR plan year at issue in this case--eliminates the need to consider potential month-to-month swings in natural gas prices, at least with regard to the utility's FPPs. In addition, and as also accurately noted by the utility, other factors (such as weather-influenced heating demand and price swings caused by hurricane activity) could also heavily influence gas prices during the purported valley months discussed by the MCAAA's witness. Finally, there appears no reason why MCAAA--in light of the fact that its witness has already begun studying this issue, as reflected by Mr. Peloquin's submission of Exhibit MCAAA-2 (which reports the monthly wellhead gas prices from 1973 through 2008)--cannot itself evaluate the potential benefits of making FPPs during the valley months and present the suggested report, should this intervenor truly feel that conducting such a study would be worthwhile.

Based on the reasons stated above, the ALJ recommends that the Commission deny MCAAA's requests to require Mich Con to both (1) abandon use of its NYMEX-based contingent factor mechanism, and (2) submit a study in future GCR proceedings on the potential benefits of focusing its FPPs on the purported valley months of April/May and September/October.

Changing from LIFO to WACOG Accounting for Stored Gas

The fifth dispute concerns Mich Con's use of annual LIFO accounting to calculate the price of gas taken from storage for use by its customers. As noted by the Attorney General, the utility has used this accounting methodology since 1956, despite the fact that its use has been a concern for the last several years. See, the Attorney General's initial brief, p. 2. Specifically, the Attorney General continues, he "addressed this issue in the 1990s, and it was considered in 2008" as part of a collaborative process that was "established pursuant to a partial settlement of Mich Con's GCR plan [proceeding] for 2008-2009" in Case No. U-15451. Id. [citing 2 Tr 287, and Exhibits AG-3 and AG-4]. In addition, he continues, the matter was revisited as part of Mich Con's 2009-2010 GCR plan in Case No. U-15701, based on MCAAA's proposal that the utility be allowed to sell--under certain circumstances--base gas held in storage with a low book cost corresponding to that established pursuant to the annual LIFO accounting method.

On each of the above-mentioned occasions, the Attorney General continues, the company opposed the various parties' efforts to impose a different accounting method with regard to gas held in storage. According to him:

> One of the arguments that Mich Con has presented for remaining on Annual LIFO [accounting] is that IRS tax considerations and other federal obstacles make any change impractical and infeasible, and perhaps impossible. Another is that a change in the storage accounting method would cause Mich Con's rate base revenue requirement to increase, offsetting any benefit from selling the gas now in storage to GCR customers at prices based on its low book costs.

Id., pp. 2-3 [citations omitted]. The Attorney General went on to assert that the Commission specifically identified the second of those two concerns as a reason for rejecting MCAAA's above-described proposal. Id. Moreover, although noting that the Commission did not specifically mention the argument regarding IRS tax considerations in so ruling, the Attorney General claims that taxation issue was a major factor in his decision not to request further consideration of the issue in either 2009 or 2010, once Mich Con presented its analysis in the Case No. U-15451 collaborative. See, Attorney General's initial brief, p. 3 [citing 2 Tr 288, as well as Exhibits AG-3 and AG-4].

The Attorney General's witness, Mr. Miller, stated that there is good reason to believe that neither of the two above-mentioned arguments for retaining the annual LIFO accounting method is still valid. With regard to the first alleged roadblock (namely, the issue of assumed IRS and other federal obstacles), Mr. Miller stated that two utilities in Pennsylvania have--since September 2010--been authorized to switch their respective stored gas accounting methodologies from the Annual LIFO methodology to the WACOG method. See, 2 Tr 288. He went on to explain that gas prices are much lower at present than when the Commission previously considered switching accounting procedures for this gas, and that the potential effect of such a change would thus be much smaller at this time than it would have been two years ago. See, 2 Tr 288-289.

Based on Mr. Miller's testimony, the Attorney General asserts that "it would be appropriate to reconsider the possibility of changing Mich Con's Annual LIFO storage accounting method." Attorney General's initial brief, p. 3. Although not specifically seeking such a change in the context of the present case, the Attorney General instead recommends that Mich Con be required to submit, within 90 days following issuance of the Commission's order in this proceeding, a report outlining what--if any--federal obstacles to converting to the WACOG methodology the utility feels may still exist and, if so, explaining "why and how its own situation differs from the situation of the Pennsylvania utilities that did change their accounting method." Id., p. 4 [citing 2 Tr 290].

MCAAA supports the Attorney General with regard to this matter, agreeing that "the issue of eliminating LIFO accounting should be re-opened" at this time. MCAAA's initial brief, p. 73. In so doing, MCAAA cites a June 28, 2011 article from the Wall Street Journal concerning an asserted Legislative proposal to bar the use of LIFO accounting for income tax purposes, supposedly as a means of helping to reduce the federal deficit. See, Id.[4]

The Staff also agrees, in significant part, with the Attorney General's recommendation to have Mich Con report on whether it feels that IRS tax considerations or other federal regulatory obstacles still make it impractical to change its storage gas accounting methodology. Specifically, while agreeing with the need for

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[4] According to footnote 31 on page 25 of its reply brief, the utility requested that MCAAA's reference to the Wall Street Journal article be stricken "since it violates Mich Con's right to due process." Mich Con's reply brief, p. 25. The company further asserted that placing any reliance on that article would violate Sections 76 and 77 of the Administrative Procedures Act, MCL 24.276 and MCL 24.277, and thus constitute reversible error. See, Id. However, no request for a hearing on this dispute was ever made, and therefore no ruling has been issued. Nevertheless, because the ALJ has neither considered the article in question nor based any part of the PFD on its purported statements, there appears no need to specifically resolve the dispute at this time.

such a report, the Staff does not think that the suggested timeframe is appropriate. Noting that “the Securities and Exchange Commission (SEC) has directed its staff to develop a work plan to help it determine whether, when, and how the current financial reporting system” for U.S.-based companies “should be transitioned to International Financial Reporting Standards (IFRS),” no specific timeframe has been established for the potential incorporation of IFRS-based accounting requirements. See, Staff’s reply brief, p. 5. The Staff therefore recommends that Mich Con be allowed to wait to reevaluate any perceived tax and other regulatory obstacles to converting from LIFO to WACOG accounting “until it knows more about the transition to IFRS.” Id.

Mich Con essentially offers three arguments in opposition to the request to reevaluate the practicality of switching from LIFO to WACOG accounting when pricing storage gas. First, with regard to the recent orders involving two Pennsylvania-based utilities, the company contends that “the regulatory climate or legal requirements in another jurisdiction . . . have no impact on a Michigan utility such as Mich Con.” Mich Con’s reply brief, p. 25. Second, the utility asserts that because the implementation of a change in inventory accounting “can only be made in a general rate case proceeding,” the Attorney General’s proposal regarding a potential switch from LIFO to WACOG accounting is “outside the scope of a GCR plan case” such as this. Id., p. 26. Third, Mich Con contends that uncontroverted testimony provided by its witness on this issue, Ms. Schmidt, reflects both that (1) Annual LIFO “is a generally accepted method of cost determination for inventory accounting,” and (2) the selection of an inventory accounting methodology by a utility is purely “a management decision” that cannot be overturned in the course of a proceeding like this. Id. [citing 2 Tr 78-79].

The ALJ does not find Mich Con's arguments persuasive on this issue, and thus concludes that the utility should be instructed to take a fresh look at both the practicality and potential benefit of changing from Annual LIFO accounting to a WACOG-based methodology. While it appears that the utility is correct in asserting that no such accounting change should be mandated in the context of the GCR plan case presently before us, this assertion misses the point. Specifically, neither the Attorney General nor his witness, Mr. Miller, currently seeks a ruling to that effect. Rather, they (along with the Staff and MCAAA) are merely "asking the Commission to require Mich Con to take an initial step that may lead to consideration of a change in Mich Con's storage accounting method in some other proceeding." Attorney General's brief, p. 5.

Moreover, although it makes sense to await a general rate case to specifically enact any such a change in accounting methodology (due primarily to the fact that it would likely need to be reflected in base rates), the ALJ concludes that this constitutes insufficient reason to strictly confine any investigation into the feasibility and merits of making that change to a future rate case. As correctly noted by the Attorney General, Act 286 of 2008, MCL 460.6a (Act 286) requires that general rate cases "be conducted on a strictly limited time schedule," thus frequently placing an overwhelming strain on the resources of the Commission and the parties alike.[5] Therefore, from a practical standpoint, it makes sense to address--outside the rate case proceeding itself--the somewhat tangential issue of whether a utility can and should consider revising its

[5] With regard to the compressed time now available for completing such proceedings, the Commission noted on page 3 of its May 26, 2009 order in Cases Nos. U-15768 and U-15751 that "Act 286 established extremely short timeframes for concluding [these] cases." This conclusion is based on the fact that Section 6a(1) of Act 286 provides that if the Commission has not issued an order within 180 days of the filing of a complete application for a rate change, the utility may self-implement any portion of its proposed change. See, MCL 460.6a(1). Moreover, Section 6a(3) of Act 286 requires the Commission to issue its final order within 12 months following receipt of a complete rate case filing, lest the application be considered approved in its entirety. See, MCL 460.6a(3).

storage gas accounting methodology. The ALJ is therefore convinced that the Attorney General's underlying proposal, to the effect that the Commission direct Mich Con to revisit the question of whether switching from Annual LIFO accounting for storage gas to a WACOG methodology is now feasible and beneficial, should be adopted.

However, the ALJ further finds that the Staff's suggested change to the Attorney General's request is reasonable and should also be adopted. When viewing this issue as a whole, it appears that the most efficient use of the parties' resources would be to allow the utility to postpone conducting its evaluation of this potential change until the SEC's staff establishes its plan (and, hopefully, the corresponding timeline) for any transition to the IFRS, rather than imposing an arbitrary 90-day deadline. For these reasons, the ALJ recommends that the Commission direct Mich Con to reevaluate (once the SEC's staff has created a proposal to transition to the IFRS) any perceived federal tax problem or other regulatory obstacles to converting from LIFO to WACOG accounting for storage gas, prepare a report regarding whether such a conversion could be reasonably accomplished, and provide each of the parties to this case a copy of that report.

Affiliate Transactions

The sixth and final area of dispute concerns MCAAA's assertions regarding the need to focus on the utility's dealings with affiliated entities, at least as those dealings might effect the overall cost of gas to its GCR customers. Using the company's purchases from MGAT as a starting point, MCAAA contends that gas acquired from all affiliated companies should be priced at or below any available non-affiliate supplies. At a minimum, it asserts, each of those purchases should be subject to strict price ceilings, and recommends using the monthly city-gate index. See, MCAAA's reply brief, p. 6. MCAAA contends that this is necessary due to the "lack of arms length bargaining . . . in transactions involving affiliates," as well as "the incentives that exist to enhance holding company profits at the expense of the regulated utility." Id.

MCAAA also urges the Commission (as it has in past cases) to take additional steps to address, on a comprehensive basis, all interactions between Mich Con and its affiliated companies. In this regard, its witness, Mr. Peloquin, testified that:

> [Act 304's] numerous requirements to minimize the cost of natural gas is also applicable to possible conflicts between MichCon's regulated gas business and the unregulated subsidiaries/affiliates of MichCon and DTE. I have attached Exhibit MCAAA-1, "Subsidiaries of MichCon and DTE." This Exhibit incorporates certain pages of DTE's Form 10K for 2009 which describes the subsidiaries and affiliates of the DTE Energy holding company system that are applicable to the GCR process. As can be seen, as a holding company, DTE owns MichCon, Detroit Edison, and a number of unregulated subsidiaries or affiliates, all heavily engaged in the energy business. This structure establishes the opportunity and incentive for the various utility subsidiaries, and the other affiliates, to self-deal within the holding corporate structure to benefit the holding Company, either directly or indirectly, and to the actual or potential detriment of ratepayers of the regulatory utility.
>
> The potential for abuse is heightened to the degree that MichCon and the parent company, DTE, have interlocking top management, or combined "service company entities." MichCon has presented no evidence that there exists checks and balances, or some independent top management at MichCon, to protect MichCon (and its ratepayers) in the event of conflicts with its parent company, DTE Energy, or its sister DTE subsidiary, Detroit Edison; or affiliates thereof, and also with other non-regulated affiliates.

2 Tr 345-346. Although offering--as part of his testimony--several discussions of a regulatory concept known as "ring fencing," Mr. Peloquin's recommendations in this case were limited to the following, with the numbering added for ease of discussion:

> [1] The Commission should require MichCon to file in GCR plan and reconciliation cases complete evidence describing in detail all of its transactions with affiliates of MichCon, DTE, Detroit Edison, and their affiliates (i.e., all affiliates) and establishing that such transactions were or are reasonable and prudent, and consistent with MichCon's duty to minimize the cost of gas.
>
> [2] The Commission should establish a process, and assign resources thereto, to obtain the books and records of the utility, and of all affiliates, and to review and audit same, as necessary to ensure that MichCon (and its ratepayers) are not cross-subsidizing affiliates. However, I am limiting my recommendation in this proceeding. I am specifically requesting the Commission to open up the books are records of MGAT in all future GCR Reconciliation cases.
>
> [3] The Commission should require MichCon to file an annual report describing all efforts and protective measures MichCon has in place or is undertaking to ensure that MichCon is not cross-subsidizing its parent company, or its affiliates, or MichCon's own affiliates (all affiliates), and to ensure that the utility is protected from adverse impacts affecting said affiliates arising from past, present, or future obligations or dealings.

2 Tr 347-348. MCAAA's briefs quote at length from Mr. Peloquin's testimony and generally ask that the Commission adopt his recommendations.

MichCon addressed MCAAA's (and, thus, Mr. Peloquin's) recommendations in the course of both its initial and reply briefs. With regard to MCAAA's suggestion that the monthly city-gate price should represent the ceiling for each and every purchase from an affiliated gas supplier, the utility asserts that this proposal is based on a "creative, but misguided, interpretation of the Commission's October 14, 2010 order in Case No. U-15451-R" (the October 14 order). Mich Con's initial brief, p. 36. Specifically, the company asserts that a reasonable analysis of this issue "properly begins with the Commission's order dated February 22, 2011," which granted Mich Con's request for clarification of the October 14 order and, in so doing, confirmed that only MGAT supply was to be priced at the city-gate index on a going forward basis. Id.

Moreover, treating MCAAA's three subsequent recommendations as a request to "adopt the concept of 'ring fencing',"[6] Mich Con argues that all such requests are irrelevant, unsupported by the record, and outside the proper scope of an Act 304 proceeding. With regard to this last argument, it contends that the concept of "ring fencing" is not an issue directly related to Mich Con's projected gas supply expenses for the 2011-2012 GCR plan year. In so doing, the company cites, among other things, the following portion of Act 304:

> In order to implement the gas cost recovery clause pursuant to subsection (2), **a utility annually shall file, pursuant to the procedures established by the commission, if any, a complete gas cost recovery plan describing the expected sources and volumes of its gas supply and changes in the cost of gas anticipated over a future 12-month period** specified by the commission and requesting for each of those 12 months a specific gas cost recovery factor. The plan shall be filed not less than three months before the beginning of the 12-month period covered by the plan. **The plan shall describe all major contracts and gas supply arrangements entered into by the utility for obtaining gas supply during the specified 12-month period.** The description of the major contracts and arrangements shall include the price of the gas, the duration of the contract or arrangement, and an explanation or description of any other term or provision as required by the commission. **The plan shall also include the utility's evaluation of the reasonableness and prudence of its decisions to obtain gas in the manner described by the plan**, in light of major alternative gas supplies available to the utility, and an explanation of the actions taken by the utility to minimize the cost of fuel to the utility.

Id., p. 30. (citing MCL 460.6h(3) [Emphasis in original]).

In considering this issue, the ALJ first finds that Mich Con's jurisdictional arguments are not persuasive. As in Case No. U-15701-R, which concerned the reconciliation of Mich Con's 2009-2010 GCR plan, MCAAA's requests appear to be addressed to the Commission's discretion. Clearly, the Commission has discretion to

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[6] Mich Con's initial brief, p. 29.

require the utility to submit information regarding the company's transactions with its affiliates, either in this proceeding or on its own, and the Commission can look to the record in any case in reaching its decision. See, i.e., MCL 460.55. Moreover, the last sentence quoted above clearly indicates that Mich Con's proposed gas purchases (including those from any affiliated entities) may be judged in comparison to other available gas supplies, and that cost minimization--whether beneficially or adversely effected by the use of affiliated companies' supply--may be considered by the Commission in deciding whether or not to approve the GCR plan in question.

The ALJ further notes that the Commission has long been concerned with affiliate transactions engaged in by regulated utilities, and has taken numerous steps in the past to protect ratepayers from their potentially adverse effects. For example, in consolidated Cases Nos. U-10149 and U-10150 (a general rate case and depreciation proceeding regarding Mich Con), the Commission adopted conditions regarding affiliate transactions which were designed to ensure that it could effectively safeguard the public interest.[7] Subsequently, in Case No. U-13502, Detroit Edison Company agreed to adopt the same affiliate transaction conditions.[8] In Case No. U-11145, the Commission reiterated that transactions between Mich Con and one of its affiliates--namely, MCN Investment Corp.--for the acquisition of GCR system supply were subject to scrutiny for reasonableness and prudence in accordance with Act 304.[9] More recently, in the

[7] See, the Commission's October 28, 1993 order, at pp. 125-129.

[8] See, the Commission's January 21, 2003 order.

[9] See, the Commission's August 13, 1997 order, at p. 14.

context of Case No. U-15451-R, Mich Con's GCR reconciliation for the 2008-2009 year, the Commission expressed its position regarding affiliate transactions as follows:

> [T]he Commission acknowledges the concern regarding affiliate purchases and the lack of evidence justifying the choice of an affiliate over a competitor. Thus, the Commission directs Mich Con to provide the Staff with information regarding the company's selection of an affiliate for each purchase of gas supply.

The October 14 order, p. 11.

Nevertheless, on the basis of this record, the ALJ does not recommend that the Commission either cap all purchases from affiliated suppliers at the city-gate monthly index price or adopt any of the other proposed remedial measures focused on Mich Con's various affiliate transactions. With regard to gas that Mich Con plans to purchase from MGAT itself, the Commission has already addressed the treatment of all such transactions in its September 22, 2011 decision in Case No. U-16146, as well as the October 14 order and its February 22, 2011 ruling in Case No. U-15451-R. As correctly noted by the utility, those Commission decisions makes it clear that--as Mr. Clinton noted--all MGAT imbalance volumes will be purchased at the Platts' Inside FERC first-of-the-month Mich Con city-gate published price index. <u>See</u>, 2 Tr 100. However, neither the above-referenced orders nor any others cited in the course of this proceeding extend such treatment to any other entities, whether affiliated or not.

As for the first of the three additional remedial measures identified by MCAAA's witness, Mr. Peloquin seeks to have Mich Con disclose its affiliate transactions and provide support for the reasonableness and prudence of those transactions in all future plan and reconciliation proceedings. This appears unnecessary because Mich Con is required to support the reasonableness and prudence of each of its transactions (with an affiliate or otherwise) in both its plan and reconciliation proceedings. MCAAA has not identified any specific information missing in that regard from Mich Con's presentation in this proceeding.

The second remedial measure proposed by Mr. Peloquin seeks access to the books and records of MGAT in all future GCR proceedings. In this regard, the ALJ does not recommend the Commission make any general pronouncements regarding those books and records at this point, largely because there has been no showing that parties to this proceeding were unable to obtain any relevant evidence regarding Mich Con's proposed dealings with MGAT. Again, the conditions adopted in the various orders cited above make it clear that the Commission (as well as its Staff) has access to the books and records of affiliates doing business with the utility.

The third remedial measure advocated by Mr. Peloquin would require the preparation and filing of an annual report by Mich Con identifying affiliate transactions and policies, as well as all other measures used (or proposed to be used) to ensure that no cross-subsidization or other adverse impacts to the utility--and thus its GCR customers--would result. The Commission already has annual reporting requirements in place for all Michigan-based utilities, and MCAAA does not explain how, and to what degree, its proposed requirement would overlap with existing requirements. As a result, the ALJ declines to recommend, on the basis of this record, that the Commission require additional annual reporting by Mich Con.

V.

CONCLUSION

Based upon the foregoing, the ALJ recommends that the Commission issue an order adopting each of the findings and conclusions set forth above. Specifically, it is recommended that the Commission (1) approve as reasonable and prudent, Mich Con's 2011-2012 GCR plan, including the gas purchasing strategy outlined by its various witnesses, (2) authorize the implementation of monthly GCR factors consisting of a base factor in the amount of $5.89 per Mcf plus any additional amounts derived from the application of Mich Con's contingent factor adjustment mechanism, and (3) accept the utility's five-year forecast.

Nevertheless, the ALJ further recommends that the Commission direct the utility to do each of the following. First, it should require the company to comprehensively analyze the results of its VCA-based FPP program, compare those results to what would have occurred had a different FPP method and/or fixed price coverage ratio been employed, and openly provide that analysis to all interested parties. Second, although authorizing Mich Con to reduce the total amount of storage capacity reserved for its GCR/GCC customers by 4.15 Bcf (pending submission by the utility of a cost-benefit analysis supporting a different level of retained storage), the Commission should demand that 2.0 Bcf of that reduction be deemed "recallable" and, thus, released for periods of one year or less. Third, it should direct Mich Con to thoroughly reevaluate--at least once the SEC's staff crafts a proposal for transitioning to the IFRS for financial reporting--any perceived federal tax or other regulatory obstacles to switching from LIFO to WACOG accounting for storage gas, prepare a report addressing whether such a conversion could be reasonably accomplished, and provide each of the parties to this case a copy of that report.

Finally, it should be noted that any arguments not specifically addressed in this Proposal for Decision were deemed to be irrelevant to the ALJ's ultimate findings and conclusions.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Mark E. Cummins

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Mark E. Cummins
Administrative Law Judge

February 29, 2012
Lansing, Michigan
drr